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Discussion Following the Remarks of Mr. Carl Beigie

QUESTION, Professor Henry King, Jr.: Mr. Beigie, you have given a pessimistic view of a progressive downturn in the U.S. currency. Is there a time frame within which the opportunity for a bilateral agreement exists, and after which it may be too late?

ANSWER, Mr. Beigie: My view is that the United States is very close to experiencing a weakening currency on a continuing basis, and a rise in interest rates. In the very near future, the macroeconomic problems I have outlined will be visible. I think the market has greatly exaggerated the present weakness of the U.S. economy.

The economic numbers are greatly distorted. The GNP in the third quarter of 1984 and the first quarter of 1985 was greatly depressed. There was a very simple reason for this. Although demand remained very strong in the U.S. economy, there was an exceptional degree of leakage of that demand into the import market.

The U.S. trade deficit doubled in the first quarter of 1985. But, if the trade component is ignored, the U.S. economy grew by a 4.4% real rate. That's not recessionary, but because production is not matching demand, income will not be flowing to those who will spend and keep the demand rising.

I believe the results of this trend will begin showing up by the end of 1985. The investment expansion was under 4% in this year's first quarter. This suggests that the tax cuts, brought in by President Reagan, brought forward investment that otherwise would have been spread-out spending over a long time period. That relatively large spurt of investment has now been depleted, resulting in a weakening of the economy. If the U.S. economy moves into a true recession—negative growth and a continuing weak demand—the dollar will have passed the point at which it should be a place for significant new investment.

If this scenario is true, then the time for a Canada-U.S. bilateral trade agreement is now; and Canada has got to decide what it wants to do in this regard.

QUESTION, Rosemary McCarney: Assuming the policy of America, *vis-a-vis* the world, that you have outlined is correct, that will not be changed by a free-trade arrangement with Canada. Will a free-trade agreement, therefore, mean that Canada and the U.S. will create a large protectionist market, leaving the rest of the global economy the same? Secondly, how do the developing countries fit into this problem?

ANSWER, Mr. Beigie: I feel that we are facing fundamental chal-

lenges, as well as opportunities, in the world economy. I feel that President Reagan has the right philosophical approach to the world economy. The way to respond to these new challenges effectively is to open up markets rather than close them down. I think by 1986 or 1987, the President will be successful with Congress in these matters, even with a weakening U.S. economy.

If a Canada-U.S. free-trade agreement is negotiated it would move the world community to start dealing with the problems in the international trading system; towards a greater trade liberalization around the world. The GATT, I think, is now outdated. The institution is falling behind the pace of the world economy. A Canada-U.S. agreement would act to move the world economy forward again.

As for the developing countries, I believe such an agreement would be a positive force as much for them as it would for the developed countries, if it were done correctly.

COMMENT, Professor Asim Erdilek: The empirical aspect of your assertions is a correct statement, but may be misleading. The U.S. balance of payments is in a flow situation which has made the country an international debtor. Although there has not been much change of inflow of capital, there has been a significant drop in outflow. There has been a turnaround in the past two years of \$2 billion. There is significant disinvestment on the part of U.S. private banks. Thus, it is not foreign money which is aiding us in financing the trade and budget deficits, but U.S. money remaining here.

Secondly, I think there is too much emphasis on interest rates. Macroeconomic research indicates interest rates are not a good determinant of capital flow. Growth rate differential seems to be much more significant to capital movement than interest rate differential *per se*.

QUESTION, Professor Erdilek: Mr. Beigie, if Canada and the U.S. move forward with a comprehensive free-trade arrangement, increasing their economic integration, how will the issue of the bilateral exchange rate be affected?

ANSWER, Mr. Beigie: First, a brief comment on interest rates. Last year the U.S. ran a current account deficit of \$100 billion. That is, \$100 billion net, in real goods, came into the United States through a current account deficit which is approximately 50% of the United States budgetary deficit. From a flow of funds standpoint, the U.S. interest rates would have been higher were it not for that flow of funds from the rest of the world. Also, there are times when psychology dominates interest rates. I argue that the psychology of voluntarily participating in the run-up of the U.S. dollar is going to shift. The U.S. will then have to find funds rather than trying to keep them surging in. It is at that time the interest rate differential issue becomes sensitive.

Concerning the exchange rate, I believe a floating U.S.-Canadian dollar, relative to the U.S., is an absolutely essential element of any effective

tive comprehensive agreement between the two countries. Though there will have to be a bilateral agreement on the degree to which it can float; no one can predict accurately what an appropriate exchange rate would be after a comprehensive trade agreement.

If there is not flexibility in the exchange rates, there is too much pressure on wage rate adjustments. It is much wiser to adjust the real wage through exchange rate movement in response to market forces, than to try to adjust it through negotiations with the labor movement. A fixed exchange rate has been in effect in the European Community and has not been working very well for those countries.

